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BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

COMPLETED ORIGINAL

Military Exchange Systems: How They Can Provide More Benefits For Military Personnel

SUMMARY

Consolidating and centralizing the military services' exchange systems could reduce costs and increase their economic benefits to service personnel.

If the Department of Defense did not require exchange systems to help fund other morale, welfare, and recreation activities, these systems could operate without appropriated-fund support; they could focus their attention on their primary mission of providing goods and services to military personnel at the lowest practicable prices.

The Department of Defense did not agree with GAO's conclusions and recommendations.

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COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

MILITARY EXCHANGE SYSTEMS: HOW THEY CAN PROVIDE MORE BENEFITS FOR MILITARY PERSONNEL

D I G E S T

Department of Defense and service officials are more concerned today than ever before with improving the quality of life of military personnel. Difficulties in recruiting and retaining personnel in the All-Volunteer Force are causing officials to seek ways to increase benefits to service personnel and to make military life more attractive. (See p. 1.)

Certain military establishments, known as "exchanges," provide authorized customers with articles and services at the lowest practicable prices and are a source of funds for other types of morale, welfare, and recreation (MWR) activities. The exchanges are organized into three separate worldwide systems. This report shows how consolidating and centralizing these systems and alternative funding practices could reduce costs and improve benefits to military personnel. (See p. 2.)

BENEFITS OF CONSOLIDATION

Reports of the Logistics Management Institute in 1968, the Office of Management and Budget in 1975, and the Defense Audit Service in 1978--as well as the services' own experience--have shown that consolidating could improve customer service and lower costs. Defense and service officials did not follow up on those reports because (1) they were not convinced large savings would occur, (2) they believed a consolidated system would be unmanageable and would not be supported by the Congress, and (3) other matters took higher priority. (See p. 5.)

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The Army and Air Force integrated and centralized management of their exchange systems and saved an estimated $96 million annually. Consolidation in 1980 of all three services' catalog business, a small segment of exchange activities, is expected to reduce operating costs by about $1.5 million. (See pp. 7 to 9.)

GAO's analysis of selected exchange functions also indicates that consolidation could reduce costs and improve benefits. For example, lower prices could result from centralized procurements based on Defense-wide requirements. (See pp. 9 and 10.)

Before deciding whether to consolidate the three exchange systems, Defense must weigh the advantages and disadvantages and compare them with alternative organizational structures. Defense has known the potential advantages since 1968, yet it has not made a followup study to help decide the matter. (See p. 13.)

RECOMMENDATIONS

To reach a decision on consolidation, the Secretary of Defense should direct the Armed Forces Exchange Coordinating Committee, or a similar study group, to identify the potential cost savings; the improved benefits to service personnel; and the feasibility of consolidating the three Defense exchange systems in whole or in part. The analyses should include

--quantifying attainable savings and improved benefits to service personnel and

--assessing Defense and service officials' concerns about consolidation and the most appropriate method for addressing them. (See p. 15.)

Defense did not agree that it should analyze the potential savings and benfits from consolidating exchange functions. On the basis of its experience and the findings in this report, it did not think such benefits would be significant. It said that catalog sales were consolidated on the basis of GAO's findings and that it would actively pursue functional centralization in the separate exchange systems. (See p. 15.)

EXCHANGES CAN BE SELF-SUFFICIENT

If Defense did not require exchange systems to help fund other morale, welfare, and recreation activities, these systems could operate without appropriated-fund support. Also, they could focus their attention on what they believe is their primary mission of providing goods and services to military personnel at the lowest practicable prices and could establish customer-savings goals rather than profit goals. (See p. 16.)

In 1978 the exchange systems had net earnings of $194 million, which was $49 million more than the amount the exchanges considered necessary to pay dividends to other morale, welfare, and recreation activities and to provide enough cash to operate successfully. The additional earnings were used primarily to increase cash and short-term investments over planned levels. (See p. 18.)

If the exchanges had paid all of their expenses charged to appropriated funds ($149.6 million) rather than providing funds for other activities, they still would have had $16 million more than needed to be self-sufficient. Preliminary operating results for 1979 show exchange profits of $222 million--about $31 million more than required to be self-sufficient. (See pp. 17 and 18.)

Unless specifically asked, Defense does not routinely inform the Congress of the amount of exchange profits, how these funds are distributed, and the use of exchange dividends by the services. (See p. 19.)

Defense and service officials oppose changing current funding practices primarily because they believe the Congress would not fund the morale, welfare, and recreation activities at their current levels. The activities, including the exchanges, received $710 million in appropriated-fund support in 1978. GAO believes the Congress would have provided a lesser amount--$677 million--in 1978 to fully fund activities had Defense justified them for the morale and welfare of service personnel and had it explained that alternative funding was more costly. (See pp. 19 and 20.)

RECOMMENDATIONS

The Secretary of Defense should

--eliminate the requirement to distribute exchange profits as a source of funds for other morale, welfare, and recreation activities;

--require the exchange systems to reimburse appropriations for costs incurred in support of exchange operations; and

--budget for and justify to the Congress the full cost of activities now partially funded with exchange profits. (See p. 21.)

Until these actions are taken, Defense should provide the Congress with information on exchange profits, how the profits are distributed, and how they are used by the services. (See p. 22.)

AGENCY COMMENTS

Defense did not agree that these activities should be fully funded directly because (1) the costs are presently shared equitably, (2) appropriated funds are needed to pay costs overseas to keep prices comparable, (3) a $33-million reduction would cause prices to increase, and (4) it had experienced difficulty in recent years acquiring appropriated funds to support those activities. GAO's proposed funding alternative would not affect sharing costs overall, would not cause prices to increase, and would not require as much appropriated fund support as the present funding method.

Defense also disagreed on the need to routinely advise the Congress of the amount and use of exchange profits because sufficient data is presently being provided. (See pp. 22 and 23.)

MATTER FOR CONSIDERATION BY THE CONGRESS

The Senate and House Committees on Appropriations should consider the direct funding of morale, welfare, and recreation activities to reduce costs to the taxpayers and to increase oversight in this area. As a basis for determining which funding method to adopt, GAO suggests that the Committees request Defense to submit data on the appropriated funds required for each alternative. If the present method of indirectly funding these activities is retained, the Committees should review the share of exchange profits being distributed and the use of funds for investments as well as for operating the activities. (See p. 23.)

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ABBREVIATIONS

AAFES	Army and Air Force Exchange Service
GAO	General Accounting Office
MCES	Marine Corps Exchange Service
MWR	morale, welfare, and recreation
NAVRESSO	Navy Resale and Services Support Office